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331-560—69——1

CITATIONS

Cases:

Miscellaneous—Continued

In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 574

UNITED STATES, PETITIONER

v.

ESTATE OF JOSEPH P. GRACE, DECEASED, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The findings and opinion of the Court of Claims (R. 56–123) are reported at 183 Ct. Cl. 745. The opinion is also reported at 393 F. 2d 939.

JURISDICTION

The judgment of the Court of Claims was entered on June 28, 1968, and amended in a nonmaterial respect on July 3, 1968 (R. 124–125). The petition for a writ of certiorari was filed on September 26, 1968 and granted on December 9, 1968 (R. 126). The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

Where, as parts of a single transaction, the decedent-husband and his wife each transferred separately owned property under substantially identical trust instruments, naming each other as life beneficiary and their family as remaindermen, whether the value of the property transferred by the wife for the lifetime benefit of the decedent-husband should be included in his gross estate under Section 811(c)(1)(B) of the Internal Revenue Code of 1939 as a transfer of property with a retained life estate.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property * * *

* * * * *

(c) * * *

(1) *General rule.*—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—

* * * * *

(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either

alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; * * *

* * * * *

STATEMENT

Joseph P. Grace (the "decedent") died in July 1950 at the age of 73 (R. 107). At the time of his marriage to Janet Grace in 1908 and thereafter he was man of great wealth (R. 88). While at their marriage Janet had no wealth or property of her own, between 1908 and 1931 decedent transferred to her title to a number of properties, including the 167-acre estate, Tullaroan, where they lived, and other real estate and securities having a cost of almost $2,000,000 (R. 89-90).

Decedent alone exercised supervision and control over the family's business affairs. He made the decisions regarding the management and disposition of the property and financial interests that were in Janet's ownership as well as his own. Janet had no interest in and took no part in business affairs; she relied on her husband's judgment. When decedent decided that some formal action was required of Janet with respect to her property, he would have the appropriate instrument prepared for her execution (R. 88).

In December 1931, decedent had prepared for his and his wife's signatures two virtually identical trust instruments providing for his transfer of property in trust for Janet for her life and her transfer of property in trust for himself for his life, with the remainders under each trust to such of their children

or the settlor as were appointed by the life beneficiary's will. For the trust of which he was the settlor ("Joseph trust"), decedent selected all the investment properties of value that he still had and deemed suitable for the corpus. For the trust of which his wife was the settlor ("Janet trust"), he selected Tullaroan and shares of stock in a personal holding company which held some of Janet's securities. (R. 92, 94–98, 100–102, 116.)

For each trust he chose three trustees, two of whom were his brother and his nephew [1] and the third of whom was the respective transferor. Each life beneficiary was entitled to the entire net income and to any of the principal, including the whole, which a majority of the trustees decided to convey to him or her. Decedent was also entitled to use and occupy Tullaroan. Each trust instrument gave decedent, during his life, the sole power to sell, invest and reinvest the corpora. Decedent executed his trust instrument on December 15, 1931, and caused Janet to execute hers on December 30, 1931. (R. 71, 73, 92–94, 98–100, 101.)

During their respective lifetimes Janet had $133,627 in income from the Joseph trust,[2] and decedent received $389,465 in income from the Janet

[1] Respectively William Russell Grace and William G. Holloway (R. 92, 98, 113; 1966 Tr. 171, 248, 310).

[2] Janet died December 31, 1937 (R. 105).

trust.[3] Decedent and his wife lived at Tullaroan until death.[4] (R. 101, 105, 107.)

After decedent's death in July 1950, the Commissioner of Internal Revenue determined that the two transfers in trust were reciprocal and added $1,116,-888 to the value of the gross estate reported in the estate tax return, the value at decedent's death of the corpus of the Janet trust. A tax deficiency of $419,-221, including interest, was assessed and paid, and after denial of claim for refund this refund suit was timely brought. (R. 107–109.)[5]

The Court of Claims found that "decedent caused his wife to create the Janet Grace trust" (R. 71 and see R. 73), that Janet's role in the two transfers was purely passive (R. 70), and that both trusts

[3] In addition, in April 1932, four months after execution of the two trusts, decedent received securities having a book value of $173,434 from the principal of the Joseph trust. Decedent and his co-trustees exercised their right to turn them over to Janet and she simultaneously turned them over to decedent (R. 96, 104, 105).

[4] On January 27, 1932, decedent exercised his power of appointment under the Janet Grace trust to give her the right to use and occupancy of Tullaroan if he died first (which did not occur) (Def. Ex. 36).

[5] After Janet's death in December 1937 the Commissioner similarly ruled that the two trusts were reciprocal, and that, to the extent of the lesser in value, one of the trusts was includible in her estate. In a compromise agreement, the Commissioner accepted the Janet Grace trust as the one taxable to her estate and its corpus was appraised at her death at $612,-334. Mutually offsetting contentions with respect to this and other issues resulted in compromise adding $336,783 to her gross estate. (R. 105–106, 118–119.)

"were created by, or at the instigation of, Joseph P. Grace as parts of what was essentially a single transaction" (R. 122–123). The court held, however, with two judges dissenting, that Section 811(c)(1)(B) of the Internal Revenue Code of 1939 would require inclusion of the Janet trust in decedent's estate only if in creating the Joseph trust he "was furnishing consideration for—*i.e.,* * * * was paying for—the subsequent creation of the Janet Grace trust * * *." According to the court "[t]his * * * involves an inquiry into the element of motivation." (R. 60.) It concluded that decedent's actions were not motivated by any intention to furnish consideration for, or to induce, or pay for, the Janet Grace trust, because (R. 68) "neither the decedent nor Janet Grace had any desire to acquire property from the other." The majority further reasoned that there was no basis in the record for a finding that Janet Grace, in making her transfer, was influenced by the circumstance that the decedent had previously created his own trust—"[o]n the basis of the whole record, it is reasonable to infer that Janet Grace executed the instrument creating the Janet Grace trust, and that she transferred property to that trust, merely because the decedent requested that she do so." (R. 70.)

The court also held that the result would be the same if the "existence of consideration" was tested by the "objective" evidence, because decedent "never said or did anything which would indicate or imply that he was motivated by the desire to avoid or lessen estate taxes when he created the Joseph Grace trust

* * * and caused his wife to create the Janet Grace trust" in 1931 (R. 70–71).

The dissenting judges argued (R. 80) that the majority has applied erroneous principles: "[T]he correct question—once the cross-trusts are seen as inter-dependent (as has been found here)—is whether the trusts created by the two settlors put both in approximately the same economic position, objectively, as they would have been in if each had created his own trust * * *." Because the transfers left decedent (R. 85) "up to the limits of his wife's trust, in the same position as if he had given himself, rather than his wife, the life interest under the Joseph trust," the dissenters thought the Janet trust should be included in decedent's estate. They were also of the opinion that even under the majority's "consideration-motivation" test the evidence showed that (R. 76) "in common sense * * * one of these inter-related trusts was in exchange for the other * * *" and that the decedent's actions were colored by estate tax avoidance motives (R. 77–79).

SUMMARY OF ARGUMENT

Section 811(c)(1)(B) of the Internal Revenue Code of 1939 provides for the inclusion in the gross estate of any transferred property in which a decedent retained a life estate. The general purpose of the statute, which has been recodified in Section 2036 of the 1954 Code, is but a specific application of the general theory of the estate tax as it was first enacted in 1916—that the gross estate must include all transfers of property which take effect upon the decedent's

death. The recognition that the retention of a life estate is in effect a testamentary disposition of the trust corpus taking effect upon death led to the passage in 1931 of the provision at issue here.

The present case involves a device known as a reciprocal trust. Decedent and his wife each established a trust giving the other a lifetime interest in the corpus. Had each established a trust while retaining a life estate therein, it would be clear that the transfers would fall within the purview of Section 811(c)(1)(B). Although the reciprocal trusts used here are outside the literal language of the statute, which speaks in terms of interests retained by the settlor, the judicial response to these and similar transactions has been to uncross the trusts and regard each party as the settlor of the other's trust. The leading authority, *Lehman* v. *Commissioner*, 109 F. 2d 99 (C.A. 2), certiorari denied, 310 U.S. 637, has been reaffirmed by the Second Circuit and has been followed by the Seventh, Eighth, and Ninth Circuits. Moreover, this judicial gloss on the statute was specifically approved by Congress in its passage of the Technical Changes Act of 1949. At that time the responsible committees recognized that the application of the *Lehman* rule was consonant with the general principle applicable in tax cases—that the economic substance of a transaction rather than the form must govern in determining tax consequences—and the Congress adopted legislation that gave limited relief, not applicable here, from certain of the tax consequences of the reciprocal trust rule.

Here, the overall state of affairs demonstrates that both trusts were created almost simultaneously as parts of a single transaction, that the decedent directed the creation of the two trusts, and that Mr. and Mrs. Grace experienced no net change in their economic positions, up to the extent of the value of the lesser of the two trusts. Thus, to that extent the net result is the same as though each of the Grace's had established a trust, retaining a life interest. Accordingly, the record presents a classic case for the application of the reciprocal trust doctrine.

The Court of Claims' holding to the contrary rests upon the belief that such trusts cannot be uncrossed unless decedent furnished "consideration" for the subsequent creation of his wife's trust. The court found crucial the absence of any evidence that either decedent or his wife were motivated to acquire property from the other. The essential error in this approach is the undue emphasis upon the subjective motivation of the parties—a factor which played no part in the formulation of the reciprocal trust rule in the various courts of appeals or in the approval of the rule by the Congress. Moreover, it is entirely unrealistic to ground the reciprocal trust doctrine upon subjective motivation in view of the fact that to the extent of the offsetting values the economic substance of such transfers is to leave the parties in exactly the same financial position as though each had given himself a life interest in the trust he had established. Taxpayers in this situation should each be regarded as the settlor of each other's trust. To

conclude otherwise would exalt form over substance and vitiate the purpose of Section 811 (c) (1) (B).

Indeed, the overall scheme of the estate tax presents objective standards for inclusion of property in the gross estate that are grounded upon the retention of interests by the decedent. With the exception of the provision for gifts in contemplation of death (Section 2035 of the 1954 Code), taxability does not depend upon the motives of a settlor but upon the nature and effect of the transfer. The test enunciated by the Court of Claims would impose a highly unworkable standard, which would require an inquiry into the motives of deceased reciprocal donors. Since the creation of both trusts were related and the economic effect of the transfers left decendent's estate undiminished to the extent of the value of what he received, decedent's motive must be irrelevant in determining the applicability of the reciprocal trust doctrine.

To the extent that the authorities relied upon by the Court of Claims' majority suggest that subjective motivation is material, we believe that they are in error. There is no connection between the bargained-for consideration concept of the law of contracts or trusts and the well-settled reciprocal trust doctrine of the *Lehman* line of cases. The crucial basis of *Lehman* and its progeny is that each transferor retained the full enjoyment of all the lifetime rights which he had in his property. In any event, all of the cases relied upon by the Court of Claims are distinguishable.

Even assuming *arguendo* the correctness of the Court of Claims' subjective motivation test, the undisputed facts require a reversal of the decision below. Under the rationale of the majority opinion, respondents had the burden of showing that decedent did not intend his wife's trust to be a *quid pro quo* for his trust. The proof, however, is entirely the other way.

The Court of Claims erred in its suggestion that proof of a tax avoidance motive would supply the necessary evidence of "consideration". Nothing in Section 811(c)(1)(B) requires the presence of a tax avoidance motive in order for the statute to be operative. In any event, the record suggests no purpose for the establishment of these reciprocal trusts other than a desire to avoid both estate and gift taxes.

ARGUMENT

INTRODUCTION

The Internal Revenue Code imposes a graduated estate tax measured by the value of the net estate passing from a decedent at his death. Ever since the first modern federal estate tax was adopted in 1916, Congress has sought to foreclose attempts to avoid tax through incomplete transfers that leave the transferor a significant interest in or control over the property during his lifetime. Thus Section 209 of the Revenue Act of 1916, Ch. 463, 39 Stat. 756, 780, required that a decedent's estate include any amount he transferred in a transaction "intended to take effect in possession or enjoyment at * * * his death".

The successors of Section 209 have long included in the comprehensive statutory definition of "gross estate" not only assets passing directly at the decedent's death, but those transferred during his lifetime in which he retained a significant incident of ownership (1939 Code Section 811; 1954 Code Sections 2031–2044). Within the latter category are transfers "under which he has retained for his life * * * the right to the income from the property" (1939 Code Section 811(c)(1)(B); 1954 Code Section 2036), the statutory provision at issue in this case. These provisions, which date from 1931,[4] and related requirements now found in Sections 2036 through 2038 of the Internal Revenue Code of 1954, in effect include in a decedent's estate the value of any property he transfers for less than full consideration during his lifetime while retaining an economic interest or control which prevents the gift from becoming "complete" up until his death. See *Commissioner* v. *Estate of Church*, 335 U.S. 632, 644.

Much of the litigation under these statutory provisions has resulted from attempts to draft instruments or invent transactions that seek to avoid the literal terms of the statutory provisions, while leaving the decedent the lifetime enjoyment of his property. Not only the specific transaction in issue here, but also the general problem that this case typifies, find their origin "in the early 1930's [when] the collective imagination of the nation's tax attorneys was fired by the tax saving possibilities seemingly offered by the

[4] Joint Resolution of March 3, 1931, Ch. 454, 46 Stat. 1516–1517.

use in closely-knit family groups of a trust device which has since become generally known as reciprocal, cross or parallel.'' [7] Under this device two or more people would each establish a trust, giving one of the others a lifetime interest in or some power over the corpus. Such an interest or power, if retained in favor of the settlor of the trust, would have required inclusion of the corpus in the settlor's estate upon his death. The hope was to avoid the thrust of the predecessors of Sections 2036–2038, which then, as now, expressly spoke only in terms of interests or powers retained in the settlor.

Although these "reciprocal" or "cross" trust transactions were in fact outside of the direct language of the statute, the courts, as soon as they were faced with the question, treated such transfers for what they were—attempts to use somewhat unorthodox approaches to achieve the substance of the partial transfers that Congress sought to deter. The courts uncrossed these trusts, relying on the fundamental rule, repeatedly reaffirmed by this Court, that tax consequences flow from the economic substance and effect of a transaction, and not its form.[8] The estate tax was applied as though each participant in a cross trust scheme was in fact the settlor of the trust in which he had an interest or over which he had a power. Then, in 1949, Congress expressly approved this line of decisions, when it adopted a pro-

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[7] Colgan and Molloy, *Converse Trusts—The Rise and Fall of a Tax Avoidance Device*, 3 Tax L. Rev. 271 (1948) (footnotes omitted).

[8] See, *e.g.*, *Helvering* v. *Hallock*, 309 U.S. 106, 114; *Goldstone* v. *United States*, 325 U.S. 687, 691; *United States* v. *Wells*, 283 U.S. 102, 116–117.

vision to give limited tax relief to certain of these cross-trust devices—not by mitigating the estate tax consequences, but by allowing certain types of retained powers to be released without incurring additional gift taxes.

In this case, "as parts of what was essentially a single transaction" (R. 122–123), the decedent-husband and his wife created similar trusts of portions of their separate estates, each naming the other as life beneficiary and their children as remaindermen. Applying the "reciprocal trust" doctrine, the Commissioner determined that upon the husband's death the lesser value of the corpus of the trust created by the wife for his lifetime benefit was includible in his gross estate under 1939 Code Section 811(c)(1)(B) as a transfer of property with a retained life estate. The Court of Claims (two judges dissenting), viewing the cross-gifts between the donor-donee spouses as if they were gifts to third parties, held that the reciprocal trust doctrine was inapplicable and accordingly overruled the Commissioner's determination.

In this brief we shall first review the line of cases which Congress approved in 1949. Those demonstrate that the transfers here are the prototype of the reciprocal trust described and disapproved by the Congressional committees in 1949. This history, as well as the general tax principles which form its foundation, fully demonstrate that the property Mrs. Grace transferred in trust for her husband's benefit must be included in his estate.

I

THE RECIPROCAL TRUST DOCTRINE REQUIRES THAT THE TRUSTS BE UNCROSSED SO THAT THE BENEFICIARY OF EACH TRUST IS DEEMED ITS SETTLOR FOR FEDERAL ESTATE TAX PURPOSES

The issue involved in this case was first considered by the Second Circuit in 1940; in the ensuing decade a line of decisions in the Second, Eighth and Ninth Circuits ruled that reciprocal trusts must be taxed according to the economic substance and effect of the transactions and not their form. In result, the settlors were "uncrossed", so that the beneficiary of each trust was treated as the settlor for the purpose of applying Section 811 of the Internal Revenue Code of 1939 and its predecessors.

The first decision, and the one that other courts have treated as the seminal authority, was *Lehman* v. *Commissioner,* 109 F. 2d 99 (C.A. 2), certiorari denied, 310 U.S. 637. There the decedent and his brother each had created in 1930 a trust of corporate shares of stock for the other's benefit for life, with remainder to the life tenant's issue, and each brother also gave the other the right to withdraw $150,000 from the principal of the trust for his benefit. Had each brother given himself the right to make the withdrawal from the trust he had established, the sum would have been included in his gross estate as an interest "of which the decedent has at any time made a transfer * * * where the enjoyment thereof was subject at the date of his death to * * * a power * * * to * * * revoke." Section 302(d) of the Internal Revenue

Act of 1926, Ch. 27, 44 Stat. 9, 71 (similar to 1939 Code Section 811(d) and 1954 Code Section 2038).[9] When one of the brothers died, his estate argued that Section 302(d) could not be applied, because he did not have a power over a trust that he himself had established.

The Second Circuit, however, disagreed. Affirming the Board of Tax Appeals, it held that the $150,000 must be included in the estate, just as though the decedent himself had established the trust from which he was allowed to withdraw corpus. The court thought the situation (109 F. 2d at 100) "in substance the same" as though "the decedent had transferred his share of the property to trustees for his own use for life, remainder to his issue, and had reserved power to withdraw $150,000." The court reasoned (*ibid.*):

> the fact that the trusts were reciprocated or "crossed" is a trifle, quite lacking in practical or legal significance. * * * The law searches out the reality and is not concerned with the form.

In addition, in the light of the stipulated facts showing that each transferor had agreed to transfer his shares "in consideration of" the other's agreement to the same effect (*id.*, 100; see, also, 39 B.T.A. 17, 20), the court ruled (109 F. 2d at 100):

[9] Only the $150,000—and not the remainder of the corpus—was placed in the estate, because the then prevailing case law held that transfers of property reserving life estates, made prior to the Joint Resolution of March 3, 1931, *supra*, were not includible in the gross estate. 109 F. 2d at 101; see *Hassett* v. *Welch*, 303 U.S. 303. However, as this Court held subsequently in *Commissioner* v. *Estate of Church*, *supra*, the entire corpus was also includible under the preexisting "possession or enjoyment" provision (Section 811(c)(1)(C)), even if the transfer occurred before 1931.

> * * * [T]he outcome would be the same if the decedent had transferred his share outright to his brother. The decisive point is that the decedent * * * caused the brother to make a transfer of property in trust under which the decedent had the right to withdraw $150,000 from principal * * *. "A person who furnishes the consideration for the creation of a trust is the settlor, even though in form the trust is created by another." Scott on Trusts, section 156.3.

In *Hanauer's Estate* v. *Commissioner,* 149 F. 2d 857, certiorari denied, 326 U.S. 770, and *Orvis* v. *Higgins,* 180 F. 2d 537, certiorari denied, 340 U.S. 810, the Second Circuit reaffirmed *Lehman.* These were cases, such as the present one, where husband and wife each created a trust for the other's lifetime benefit with remainder to their joint issue.

In *Hanauer,* the court of appeal affirmed the Tax Court's finding that the failure of the husband and wife each to create his or her respective trust (149 F. 2d at 858) "independently and apart" showed that each was established "in consideration of the other." In doing so, the court made clear that it did not refer to consideration in the sense of a negotiated bargain in which each party is motivated by the desire to obtain the other's property. Rather the court said (*id.,* 859) that the decedent-husband's "motive was not controlling" and that it was "not essential" to support the inclusion in the husband's estate that there be evidence to "support a finding that the wife's transfer was effective to bring about the decedent's transfer." Indeed, much like the pres-

ent case, the wife was "accustomed to rely upon the business men of the family" (*id.*, 858); she set up her family trust "only because of her conviction that 'if he (the decedent) thought it was good for him it would be good for me to do too'"; she "did not know the value of" her husband's trust; and she even left it to her husband and son-in-law to select the properties for her trust (*id.*, 858–859). The fact that (*id.*, 859) "the two trust indentures were contemporaneously developed and executed as though all part of a single transaction" was sufficient to support the Tax Court's finding that they were "in consideration of" each other (*id.*, 858). Then, in *Orvis*, the same court reversed a district court decision for the husband's estate where the family trusts were executed six days apart, on the basis of the spouses' knowledge of each other's intentions and the absence of any independent reason for the crossed life estates.

The Eighth Circuit decided the question in *Cole's Estate* v. *Commissioner*, 140 F. 2d 636. The husband, in 1931 had transferred 700 shares of stock in trust for his wife for life with remainder to their children and grandchildren, and on the same day the wife had transferred 300 shares in trust for the husband for life, with the same remaindermen. Both the husband and wife died during 1939. The court held that 300 shares should be included in each estate. In rejecting the taxpayer's argument that the Tax Court's decision in favor of the government was fatally defective because there was (*id.*, 637) "no finding that one trust was made in consideration of the other," the court concluded that the lower "court's decision

may be sustained on another basis". Thus it thought the situation was "the same as if one decedent had 'exchanged' 300 of his shares for 300 shares of the other. * * * [I]n an exchange the property received is consideration for the property given" (*ibid.*). The court of appeals further observed that even in the absence of the "exchange", the reciprocal trusts would not have operated to exclude the stock from the estate tax because the transferors retained "equivalents" (*id.*, 638):

> each decedent "retained the substance of full enjoyment of all the rights [for life] which previously he had in the property." *Helvering* v. *Clifford*, 309 U.S. 331, 336 * * *. To the extent of the income from 300 shares of the stock there was no change in the economic position of either grantor.

And the court insisted that the decedent's motives were immaterial, as (*id.*, 638) "with few exceptions the law attaches legal consequences to what parties do, quite independently of their private purpose or intent". The Eighth Circuit, like the Second, has reiterated and adhered to its position in subsequent cases. See *Guenzel's Estate* v. *Commissioner*, 258 F. 2d 248, 254; *Moreno's Estate* v. *Commissioner*, 260 F. 2d 389.

The Ninth Circuit, in a case growing out of a round robin of trusts established by three brothers, each for the benefit of one of the others, relied on *Lehman* in holding that the beneficiary of each trust should be treated as the settlor for gift tax purposes. *Commissioner* v. *Warner*, 127 F. 2d 913. And the Seventh

Circuit has twice followed the lead of *Lehman* in applying the estate tax. *Olson* v. *Reisimer*, 271 F. 2d 623, and *Glaser* v. *United States*, 306 F. 2d 57.[10]

The rule developed in this line of cases refuses to allow formal devices to overcome the requirement that a taxable estate include any amounts the decedent transferred during his life while retaining an interest in or power over the property. Rather, this "reciprocal trust" rule looks to the economic effect of what has occurred. Unless the taxpayers can show that the trusts were wholly unrelated to each other, they are reciprocal. Once they are so classified, the trusts must be uncrossed, and each included in the estate of the

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[10] Compare, however, the two to one decision in *McLain* v. *Jarecki*, 232 F. 2d 211, where the Seventh Circuit affirmed a trial court decision declining to find reciprocity in trusts created by husband and wife, each having provided that the other was to receive the trust income after the settlor's death. The court based its decision on a conclusion that none of the stipulated facts expressly showed that the husband "brought about the transfer from his wife * * *." (*Id.*, 213.) In *Glaser* v. *United States*, *supra*, though, in an indistinguishable situation, the same court reversed a district court finding that there was no reciprocity in a transaction where a husband and wife conveyed land in fee to their daughter and son-in-law at the same time as the latter conveyed land to the parents for life with the remainder to another child. Without referring to its earlier decision in *McLain* the court ruled that (306 F. 2d at 61) "looking through form to substance, however, decedent and his wife merely substituted one piece of property for another of equal value." Thus, the father's estate was taxed on the value of half the property he received—"as if the transfer * * * had emanated from decedent and his wife and as if they had retained joint life interests therein." Consequently we assume that *Glaser* and *Olson*—and not *McLain*—represent the rule that now applies in the Seventh Circuit.

respective beneficiary, to the extent they offset each other. Subjective motivation—*i.e.* whether each transferor *intended* to give consideration—is immaterial. The economic facts themselves control the tax consequences.

This result is as it should be. The courts have repeatedly refused to allow formalisms, however ingeniously devised, to be used to escape tax consequences that Congress has attached to a transaction having a particular economic substance. Once it is shown that a decedent and one or more other persons each has an interest in, or a power over, a trust one of the others created, the overall state of affairs must be measured against the purpose of Section 811 or the parallel provisions of the 1954 Code. The statute must be applied so as to include in the decedent's estate the value of the trust of which he is a beneficiary, at least to the extent that it offsets the value of property he transferred for one of the other's benefit, since the result is exactly the same as though the decedent had retained an interest in, or power over, the trust he himself transferred. To rule otherwise, as the Court of Claims has, would allow those in a position to place large sums in trusts to deplete their taxable estates while retaining full enjoyment of all their assets, simply by creating cross trusts in favor of each other with remainders to their children.

II

CONGRESS HAS APPROVED THE RECIPROCAL TRUST DOCTRINE OF THE *LEHMAN* LINE OF CASES

The rule in *Lehman* and *Cole's Estate* was commonly accepted as having put to rest—at its birth—this once popular device for avoiding estate tax. See Colgan and Molloy, *Converse Trusts—The Rise and Fall of a Tax Avoidance Device,* 3 Tax L. Rev. 271, 273 (1948). These cases, moreover, formed the background for the Congressional action that, in 1949, demonstrated full legislative approval of the *Lehman* rule.

At that time persons who had participated in reciprocal trust arrangements had made transfers of their property that in form were complete. Yet, because of *Lehman,* they had failed in their efforts to take the property out of their taxable estates, since, in substance, they had retained some interest in or a power over the property. To remove such property from the estate by means of an inter vivos surrender of that interest or power would result in a taxable gift. Furthermore, such a transfer possibly could have estate tax consequences as a transfer in contemplation of death.

In the enactment of the Technical Changes Act of 1949, Ch. 720, 63 Stat. 891, Congress was requested to mitigate the burdens of these tax consequences. The committee reports expressly endorse the rule of *Lehman* as necessary and sufficient to overcome a tax avoidance device. Thus, the Senate Committee stated

(S. Rep. No. 831, 81st Cong., 1st Sess., pp. 5–6):

6. *Reciprocal trusts.*

Prior to 1940 certain reciprocal trusts were established with the apparent intent of minimizing estate taxes by what were then considered effective means. For example, an individual might establish a trust providing that the corpus of the trust would be payable to his children upon his death. Under the general plan followed, certain rights in the trust were also given to his wife. These rights might consist of a general power to invade the corpus, to change the beneficiaries or to change the amount which they would receive. At the same time or a short time after the husband set up the trust, his wife would also establish a trust with assets of a similar amount, vesting in him powers equivalent to those he had vested in her. By this reciprocal device it was thought that two persons could transfer property to their heirs without diminishing effective control during life but still paying the gift tax rather than the estate tax.

The acceptance by the Treasury, prior to 1939, of the gift taxes paid (and, it is claimed, the assertion of occasional deficiencies) caused some taxpayers to believe this was a legitimate device.

However, in 1940 in *Lehman* v. *Commissioner,* 109 Fed. (2d) 99, the Circuit Court of Appeals for the Second Circuit held that where trusts are found to have been created each in consideration of the other, the nominal grantors are to be interchanged for tax purposes. Thus, in the type of case discussed above, the husband would be considered the grantor of the trust created by the wife, and vice versa. This

means that the husband is considered to have reserved powers in the trust nominally set up by his wife. This, under present law, is sufficient to require inclusion of the entire trust corpus in his gross estate upon his death.

The court decisions in 1940 and subsequent years put taxpayers on notice as to the probable tax consequences of reciprocal trusts in the future. * * *[11]

Section 6(a) of the Technical Changes Act of 1949, *supra*,[12] allowed grantors of trusts with reciprocal powers created prior to 1940 (the year when *Lehman* was decided) an opportunity—good until December 31, 1950—to relinquish the retained powers without incurring additional gift tax, if gift tax had been paid on the original transfers.[13] Section 6(c) also allowed relinquishment to be made without possible estate tax liability as a gift in contemplation of death. Congress, however, denied similar relief to transferors who wished to relinquish (S. Rep. No. 831, *supra*, p. 6) "a life estate or other interests (as distinguished from * * * a power) which has been created in a reciprocal trust". Presumably Congress agreed with this Court's statement in *Commissioner*

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[11] The House Committee Report makes a substantially similar statement. H. Rep. No. 920, 81st Cong., 1st Sess., p. 5.

[12] A new subsection 1000(g) was added to the Internal Revenue Code of 1939.

[13] See, also, H. Conf. Rep. No. 1412, 81st Cong., 1st Sess., p. 6. In contrast, Section 8 of the same Act allowed the tax free release of a retained life estate, or a reciprocal life estate, under a transfer made prior to the Joint Resolution of March 3, 1931. The purpose was to grant relief from some of the consequences of the 1949 decision in *Commissioner* v. *Estate of Church*, see p. 16 n. 9, *supra*.

v. *Estate of Church, supra,* at 645, that retention of the right to income for life is "far more than [to] attach a 'string' to * * * property," but is retention of "a most valuable property" right which prevents a gift from becoming "complete", and therefore did not merit special relief.

The legislative purpose could not be clearer. Congress saw *Lehman* as an appropriate judicial response to a taxpayer "device" used in an attempt to avoid Section 811(c)(1)(B) and its predecessors. To ease some of the tax consequences of *Lehman* limited tax relief was granted to those who failed to anticipate that the courts would rule as the Second Circuit did in that case. The objective plainly was to facilitate the continuing judicial application of the *Lehman* case.

Moreover, the relief granted was severely limited, apparently to what Congress thought were the situations where a taxpayer, before *Lehman,* might reasonably have failed to anticipate the reciprocal trust rule. Thus relief was denied to anyone who established such a trust after *Lehman,* and even those people were given but a limited time to relinquish the powers retained over property placed in a reciprocal trust before *Lehman.* Furthermore, the relief was limited to only those who retained powers over—as opposed to a life interest in—the cross trusts, thus reflecting an apparent Congressional judgment that even before *Lehman,* the creation of crossed life interests—as occurred here—presented a rather obvious case for uncrossing the trusts.

It is therefore the standards developed in *Lehman, Cole's Estate,* and like cases that must control this litigation. The trusts involved here and the circumstances of their formation are essentially indistinguishable from the ones involved in those cases, and the present problem must yield to the analysis advanced in the Second and Eighth Circuits and accepted by the Congress. We shall now turn to an application of that analysis to the facts of this case, and an examination of the grounds advanced by the Court of Claims for its decision that Mr. and Mrs. Grace managed to place their property beyond the reach of Section 811(c)(1)(B) of the Internal Revenue Code of 1939.

III

THE COURT OF CLAIMS ERRED IN HOLDING THAT DECEDENT'S AND HIS WIFE'S TRANSFER TO AND RECEIPT OF PROPERTY FROM EACH OTHER WERE INSULATED FROM THE *LEHMAN* RULE

A. THIS CASE PRESENTS THE PROTOTYPE OF THE RECIPROCAL TRUST DEVICE ENCOMPASSED BY THE RULE OF *LEHMAN*

There is no dispute about the crucial facts of this case. The decedent-husband transferred properties in trust for his wife for life with remainder to their family, and under a virtually identical trust, arranged simultaneously by the decendent (R. 92) but dated two weeks later, "acting in accordance with the plan of the decendent" (R. 98, and see also R. 65), his wife transferred properties in trust for his life with similar remainder. The properties transferred by the wife

were those (R. 101) "previously selected by the decedent." The two trusts were established as (R. 122–123) "parts of what was essentially a single transaction," and the husband (R. 71 and see R. 73) "caused his wife" to execute her trust.

This record thus presents the prototype of the reciprocal trusts described by the Congressional Committees in 1949. Since the parties remained in the same economic position (to the extent of the lesser value of the wife's trust) as if each had created a trust of his or her own property with a retained life estate in the same property, the value of the property transferred in trust by decedent's wife was substituted for his own and should be includible in his estate under Section 811(c)(1)(B). By making reciprocal transfers each transferor-transferee in effect and for all practical purposes "retained" for life the enjoyment and right to the income from the property he had transferred up to the extent of the lesser value of the trust he had his wife establish for his own benefit. On this record this case is entirely indistinguishable from *Hanauer's Estate, supra, Orvis* v. *Higgins, supra,* and *Cole's Estate, supra.* It thus comes within the rule approved by Congress in 1949, and that rule requires the inclusion of the value of the Janet trust in decedent's estate.

B. THE COURT OF CLAIMS ERRED IN HOLDING THAT THE *LEHMAN* RULE WOULD APPLY ONLY IF DECEDENT HAD A SUBJECTIVE DESIRE TO OBTAIN HIS WIFE'S PROPERTY

In this case, the primary holding of the majority of the Court of Claims was that the reciprocal trust rule

of *Lehman* (R. 60) "involves an inquiry into the element of motivation," and that the Janet trust should be included in decedent's estate only if he, in creating his trust, "was furnishing consideration for—*i.e.,* whether he was paying for—the subsequent creation of the Janet Grace trust." In deciding this question in favor of the taxpayer, the court concluded (R. 68) "neither the decedent nor Janet Grace had any desire to acquire property from the other"; "the decedent, when he created the Joseph Grace trust * * * was not motivated by any intention to give consideration for, or pay for" or (R. 69) "to induce Janet Grace to transfer" her assets in favor of decedent.

But this approach misconceives the interpretation of Section 811(c)(1)(B) of the 1939 Code rendered in *Lehman* and approved by the Congress in 1949. Nothing in the cases approved by Congress depends on or calls for "an inquiry into the element of motivation." To the contrary, the Second Circuit insisted in *Hanauer's Estate,* 149 F. 2d at 859, that the decedent's "motive was not controlling". And the Eighth Circuit made clear in *Cole's Estate* that the settlors should be uncrossed whenever the trusts have left the decedent's economic position essentially unchanged. See 140 F. 2d at 637. See, also, *Guenzel's Estate* v. *Commissioner, supra,* 258 F. 2d at 254; *Olson* v. *Reisimer, supra,* 271 F. 2d at 626-627, quoting from *Moreno's Estate, supra,* 260 F. 2d at 392.

Nor should questions of subjective motivation play any part in determining whether decedent's estate should include the value of the Janet trust. The essential question instead goes to the relationship between

the trusts. Since, as the Court of Claims found, respondents failed to prove that each trust was unrelated to the other, there can be only one answer to that question here. The two trusts were executed within a span of two weeks, were virtually identical in terms, were executed "in accordance with the plan of the decedent," and were "parts of what was essentially a single transaction" (R. 92–94, 98–100, 102, 122–123). Decedent in addition "caused his wife" to execute her trust in his favor (R. 71 and see also 73). On this record it is plain that these trusts were intimately connected in their inception and that is enough to invoke the rule of *Lehman*.

Once these facts are found, the subjective reasons that motivated Mr. and Mrs. Grace can have no pertinence. Of course, neither decedent nor his wife was prompted by a desire to purchase or obtain the property of the other. But what would be the significance of such a motive? Under the series of transfers the decedent devised and had executed, there was no practical change in the family financial condition. As a result of the transfers, Joseph Grace did not part with more than the difference between the value of his transfer to Janet and her transfer to him. To this extent the situation is in substance exactly as though he had established one trust for his own benefit, and she had established one for her benefit. In these circumstances, the trusts must be uncrossed for the purpose of applying Section 811(c)(1)(B) of the 1939 Code, unless the substance of what occurred is to be entirely masked by the form of the trusts.

This is the only result that can be squared with the purpose of Section 811(c)(1)(B) and the related provisions of the estate tax. In construing and applying taxing statutes—whether income, gift, or estate tax provisions—this Court and lower courts have consistently looked through legal form to economic substance.[14] Thus this Court has held on several occasions that an estate tax cannot be avoided by any trust transfer except by (*Commissioner* v. *Estate of Church, supra,* at 645; *Estate of Spiegel* v. *Commissioner,* 335 U.S. 701, 705):

> a bona fide transfer in which the settlor, absolutely, unequivocally, irrevocably, and without possible reservations, parts with all of his title and all of his possession and all of his enjoyment of the transferred property.

It is equally settled that the means a taxpayer uses to retain the economic value or control of his property are of little importance, since (*Goldstone* v. *United States,* 325 U.S. 687, 691):

> Testamentary dispositions of an *inter vivos* nature cannot escape the force of this section by hiding behind legal niceties contained in devices and forms created by conveyancers.

And (*Commissioner* v. *Estate of Church, supra,* at 644)—

> "In determining whether a taxable transfer becomes complete only at death we look to sub-

[14] *E.g., Commissioner* v. *Estate of Church, supra; Goldstone* v. *United States, supra; Estate of Spiegel* v. *Commissioner, supra* (estate tax); *Burnet* v. *Guggenheim,* 288 U.S. 280 (gift tax); *Gregory* v. *Helvering,* 293 U.S. 465; *Knetsch* v. *United States,* 364 U.S. 361; *Commissioner* v. *Brown,* 380 U.S. 563; and *Helvering* v. *Clifford,* 309 U.S. 331 (income tax).

> stance, not to form * * *. However we label the device [if] it is but a means by which the gift is rendered incomplete until the donor's death" the "possession or enjoyment" provision applies.

The rule which we urge here is but an application of these principles to the device of reciprocal trusts. The estate tax is on the "value" of property passing at death, rather than on any other measure. An *inter vivos* transfer of properties under which the transferor retains the continuing right to their possession, enjoyment and income is a retention of (*Commissioner* v. *Estate of Church, supra,* at 644) "[p]robably their greatest property value," which prevents the value of the decedent's estate from being depleted. This being so, in economic reality it makes no difference to the transferor whether the "value" he retains up to his death is in the precise property he transferred or its equivalent value in substituted property.

With one exception—the section dealing with transfers in contemplation of death [15]—the scheme of taxing estates is grounded upon the net economic effect of a decedent's actions. The essential concept of the statute is to allow the value of property to escape the estate tax only if the decedent completely parted with it during life. However, the date-of-death value of all property transferred during life is included in the gross estate if the decedent retained some significant interest in it. In the application of these provisions, economic realities have always superseded

[15] Section 811(c)(1)(A) of the 1939 Code; Section 2035 of the 1954 Code.

questions of the decedent's subjective motive. Thus this Court said with respect to transfers "intended to take effect in possession or enjoyment at or after [decedent's] death"[16] (*Estate of Spiegel* v. *Commissioner,* 335 U.S. 701, 705–706), taxability "does not hinge on a settlor's motives, but depends on the nature and effect of the trust transfer." It is even "immaterial" whether the reservation of such a power is "deliberate", for "[a]ny requirement * * * such as a post-death attempt to probe the settlor's thoughts in regard to the transfer, would impair the effectiveness of the 'possession or enjoyment' provision as an instrument to frustrate estate tax evasions." If this is true with respect to Section 811(c)(1)(C), which uses the word "intended," it can hardly be less true with respect to Section 811(c)(1)(B)—at issue here—which includes in estates the value of property transferred while the decedent in fact "retained" possession or enjoyment for life. As this Court said *Commissioner* v. *Estate of Church, supra,* 335 U.S. at 638:

> "It is true that an ingenious mind may devise other means of avoiding an inheritance tax, but the one commonly used is a transfer with reservation of a life estate." *Matter of Keeney,* 194 N.Y. 281, 287, 87 N.E. 428, 429; *Keeney* v. *New York,* 222 U.S. 525. * * *

To apply to prearranged husband and wife crossed trusts and life estates the test of whether or not they were induced by the desire to obtain each other's property, in order to determine whether they are includible in the gross estate under Section 811(c)(1)

[16] Section 811(c)(1)(C) of the 1939 Code; Section 2037 of the 1954 Code.

(B), would nullify the reciprocal trust rule in the field in which Congress thought it had its most important application. See (pp. 22–25, *supra.*) As the dissenting judges in the Court of Claims pointed out (R. 72), the desire to obtain each other's property is the least of husbands' and wives' normal motivations for such crossed transfers. Wealthy husbands and wives who have ample additional means or who for other reasons do not covet each other's property could rarely be found to have set up such trusts in order to induce or pay for each other's transfer. And Congress could hardly have believed that the rule it approved would apply only to those husbands and wives who are sufficiently estranged so as to bargain with each other at arm's length or who set up reciprocal trusts because they are motivated to acquire each other's property.

If the economic effect of the transfers is to leave the value of the husband's estate undiminished to the extent of the value of what he received, the decedent's motives for his actions must be immaterial for purposes of determining the value of his taxable estate. To permit the applicability of Section 811(c)(1)(B) to turn on the ascertainment of the motives of the deceased reciprocal donors—here motives for actions taken more than 35 years ago—is to substitute an impractical subjective test for the objectively workable test demanded by the statute. In the words of Professor Lowndes (*Consideration and the Federal Estate and Gift Taxes,* 35 Geo. Wash. L. Rev. 50, 80 (1966)):

> If, as a result of transfers by related taxpayers, a transferor ends up in exactly the same posi-

> tion as he would have been if he had made a taxable transfer, there is no obvious equity in treating him as though he made the transfer in which he acquired a taxable interest. * * * a "net effects" test is * * * the only genuine test which can be applied to * * * transfers by related taxpayers. A "consideration test" based upon the unknown and unknowable state of mind of the transferors is sheer fiction; it is no test at all. * * *[17]

C. THE AUTHORITIES RELIED ON BY THE COURT OF CLAIMS WERE WRONGLY DECIDED TO THE EXTENT THEY SUPPORT THE DECISION BELOW

The Court of Claims distilled its "consideration-motivation" test from (R. 59–60) *In re Lueders' Estate*, 164 F. 2d 128 (C.A. 3) and *Newberry's Estate* v. *Commissioner*, 201 F. 2d 874 (C.A. 3).[18] Those cases, to be sure, do suggest that the subjective motivation

[17] See, also, Lowndes and Kramer, *Federal Estate and Gift Taxes* (2d ed. 1962) pp. 195–196.

[18] The court also relied on *McLain* v. *Jarecki*, 232 F. 2d 211 (C.A. 7). As we have noted above (p. 20 n. 10), that case no longer represents the position of the Seventh Circuit.

The majority also cited *Tobin* v. *Commissioner*, 183 F. 2d 920 (C.A. 5). There the question was whether a husband and wife should be taxed during their lives on the income produced by trusts that each had established by instruments directing the accumulation of income until an advisory committee directed its payment to the spouse of the settlor. *Tobin* was thus an income tax case involving a different statutory provision. There was no question of an income escaping taxation, and the taxpayer-husband had renounced his right to share in the trust income. The court did not discuss its reasons for holding the "reciprocal trust rule" inapplicable but merely said that in the circumstances (183 F. 2d at 921) "the *Lehman* case in no wise requires a holding that the trusts were reciprocal."

of the settlors is relevant—*i.e.,* that the trusts should be uncrossed only if each settlor subjectively *intends* to provide consideration for the other's transfer. However, the factors we have discussed above (pp. 20–34) establish the error of such an analysis, which applies a subjective motivation test taken from the law of trusts or contracts rather than the rule of substance over form that has been the hallmark of the application of the Internal Revenue Code. As the Eighth Circuit stated in *Guenzel's Estate* v. *Commissioner, supra* (258 F. 2d at 254), these decisions err in approaching the problem only "from a trust standpoint," while the "real basis" for the *Lehman* line of cases is that each transferor has retained " 'equivalents" and "the substance of full enjoyment of all the rights [for life] which previously he had in the property'." In addition, *Newberry's* Estate makes no mention of the Congressional intent reflected in the enactment of the 1949 relief legislation and the committee reports thereon.[19]

Nor is it at all clear that these decisions support the Court of Claims decision here, once their facts are analyzed. In *Lueders' Estate,* a husband and wife, 15 months apart, each created a trust, giving the other a life estate and power to terminate in favor of the beneficiary.[20] The two trusts had not been

[19] *In re Lueders' Estate, supra,* was decided in 1947.

[20] Apparently following its own prior decision (reversed subsequently by this Court) that even a life estate retained by the transferor would not subject the decedent's property to estate tax (*Commissioner* v. *Church's Estate,* 161 F. 2d 11 (C.A. 3), reversed, 335 U.S. 632), the court considered the issue without regard to the life estate received by Mrs. Lueders.

created as parts of a single transaction and there was no suggestion that the wife had agreed to make her transfer on account of the husband's. The Third Circuit reversed the Tax Court decision that the powers to terminate were reciprocal, holding that there was an absence of consideration under the law of contracts. However, it distinguished *Cole's Estate and Hanauer's Estate* on the ground that the trusts there (as here) were executed essentially at the same time, and did not express disagreement with these cases.

In *Newberry's Estate* v. *Commissioner, supra,* the husband and wife had each transferred property irrevocably in trust for their children at about the same time. Although they had *not* created life estates for each other, each gave the other the power to shift beneficiaries among their issue, spouses of issue, and charities, a power which neither in fact exercised. Because of the power, upon the death of the wife the Commissioner included the husband's trust in her estate under authority of Section 811(d)(2) of the 1939 Code, as a transfer with a reserved power to alter or amend (201 F. 2d at 876). The Third Circuit, however, accepted the surviving husband's testimony that they had given each other the powers only out of a fear that some "schemers or ne'er-do-wells" might marry their children and obtain control of the funds. The court's statements that (201 F. 2d at 877–878) a subjective intent to give consideration is required seemed to be confined to situations where the parties granted to each other limited powers which were not actually exercised, a substantially different circum-

stance than here, where life estates were granted and enjoyed.[n]

D. THE DECISION BELOW CANNOT STAND EVEN WITHIN THE CONTEXT OF THE COURT OF CLAIMS' SUBJECTIVE MOTIVATION TEST

Even assuming *arguendo* the correctness of the Court of Claims' own test of subjective motivation, the undisputed facts demonstrate that its decision should be reversed. Central to the majority's conclusion that there was no mutual bargaining by the decedent and his wife was its emphasis upon the fact that there was (R. 70; and see also 102) "no evidence in the record that Janet Grace even knew about the creation of the Joseph Grace trust by the decedent." However, such an analysis overlooked Janet Grace's entirely passive role in the family financial decisions. She relied upon her hus-

[n] Compare *McNichol's Estate* v. *Commissioner*, 265 F. 2d 667, 670 (C.A. 3), certiorari denied, 361 U.S. 829. That case cited with approval *Orvis* v. *Higgins*, *supra*, *Cole's Estate* v. *Commissioner*, *supra*, and *Moreno's Estate* v. *Commissioner*, *supra*, in holding that a decedent's estate must include property he put in an inter vivos trust nominally for the benefit of his children, but with an oral understanding that the decedent would receive the income for his life. It stated those cases "hold that when two persons separately create equivalent trusts simultaneously, with income payable from each trust to the settlor of the other, the property transferred by each settlor is nevertheless subject to § 811(c)(1)(B)." of the 1939 Code.

See, also, *Estate of Newberry* v. *Commissioner*, 172 F. 2d 220 (C.A. 3), affirming *per curiam* decision of April 30, 1947 (P-H Memo T.C., par. 47, 113); *Estate of Oliver* v. *Commissioner*, 148 F. 2d 210 (C.A. 3), affirming *per curiam* decision of April 28, 1944 (P-H Memo T.C., para. 44,138). Both held that simultaneous trusts with crossed life estates should be treated as transfers retaining life estates, without any discussion of whether or not one induced the other.

band for all business judgments and decisions (see, *e.g.*, R. 62–63, 70, 88, 92, 98, 100–101, 102; Findings 5(a), 10, 12(a), (b), (e)), including a willingness to transfer property for his benefit (R. 70) "merely because the decendent requested that she do so". Surely then, decendent was, at the least, the agent of his wife with complete authority to act on her behalf in financial and business matters, including the creation of the reciprocal trusts. What Janet Grace might or might not have thought or done in 1931 is of no importance, since it is clear that she would have done whatever her husband asked.

Accordingly, the proper focus of the inquiry should not hinge upon the existence of negotiations between the decedent and his wife but upon the decedent alone and what *he* did. He had two roles. He was acting on his own behalf and he was also acting for his wife, in financial affairs generally and with respect to the reciprocal trust in particular.

Even under the Court of Claims' theory, the burden of proving lack of bargaining is the taxpayer's and not the government's. See *Orvis* v. *Higgins*, *supra*, 180 F. 2d at 541; *Estate of Eckhardt* v. *Commissioner*, 5 T.C. 673, 680. At the least, therefore, respondents had to prove an absence of intent to provide consideration. Thus they had to prove that Joseph Grace did not intend that the trust he had his wife establish for his benefit would be a *quid pro quo* for the trust he established for her benefit.

The evidence, however, all points the other way. The Court of Claims found that decedent was willing to put into the trust for Janet's lifetime benefit (R.

116) "all the properties of value which he still had and which were of such a nature that they would be suitable" for such a trust. It was all planned and executed as part of a single transaction (R. 122–123). There is no basis in the evidence or the findings for an inference that he did not consider it important to obtain the right to possession and enjoyment of Tullaroan (including the right to its sale and reinvestment of the proceeds for his benefit) and the income from her securities as a necessary offset to the stripping of his own assets. It defies reality to hold on this record that consideration was not intended.

Nor is it enough, as the Court of Claims said (R. 71) to await proof of a tax avoidance motive to find adequate evidence of "consideration." Section 811 and its counterparts in the 1954 Code—except those involving gifts made in contemplation of death—all turn on the nature and on the effect of a given transaction and not on the decedent's motive. To make the result depend on proof of or the absence of proof of tax motivation—which is hardly ever proclaimed—would depend upon the haphazard availability and amorphous recollection of witnesses as to the state of mind of decedents many years earlier (here more than 35 years).

At all events, the evidence that decedent was motivated by the desire to avoid estate tax as well as gift tax [22] is particularly strong. No other rational purpose was shown for his causing his wife to transfer the life interest in an estate on which he expected to and

[22] See R. 92, 116; R. 70, 74; Op. 12, 16.

did live for the rest of his life (R. 101; R. 69), and which he could have obained from his wife at any time merely for the asking (R. 70).[23] In addition, in 1931 a Grace National Bank trust officer, Alan Ross was promoting reciprocal trust plans as a tax avoidance device among various officials of the bank and its parent company, W. R. Grace & Company, of which the decedent was board chairman. The plan was put into effect for that purpose by D. Stewart Iglehart, a personal friend of decedent and president of W. R. Grace & Company. Thereafter, although he had never previously made gifts with retained or crossed life estates, Joseph Grace, who was shown to have expressed interest in the effectiveness of Ross's plan for estate tax purposes, approached his trust adviser at W. R. Grace & Company with a draft or drafts of trust instruments for his use, copied from Iglehart's trust and prepared for Ross's signature on behalf of the Bank as trustee (R. 3-8). Neither Ross nor the Bank had ever previously handled decedent's family affairs. (R. 110-118; see, also, R. 77-79).

The majority's statement that (R. 71) decedent never said or did anything which would indicate or imply motivation to avoid estate tax wholly disregards this evidence. The only reason which it expressly states for its inference that (R. 73) "Joseph

[23] For example, "on March 31, 1929, Mr. Grace had Mrs. Grace retransfer to him * * * shares of stock * * * having a book value of $613,444.32" (R. 110); and on January 27, 1932, decedent had Janet return to him $173,434 in book value of assets in the Joseph trust, only four months after he created it. See p. 5 n. 5, *supra*.

Grace * * * was not attempting to carry out the Ross plan to minimize estate taxes" in making his family dispositions in the manner he did is that (R. 73)—

> Mr. Grace created the Joseph Grace trust on December 15 and caused Mrs. Grace to create the Janet Grace trust 15 days later, whereas an essential part of the Ross plan to lessen estate taxes was the lapse of a considerable period of time between the creation of trusts by a husband and wife.

All this proves, of course, is that decedent may have been less cautious than Ross or was unwilling to subject himself or his wife to possible reenactment of the gift tax if he waited until 1932. (R. 92, 116).[34]

The Court of Claims did suggest that decedent established his trust as (R. 74) "another step in a long-established pattern of family giving". But decedent's trust departed entirely from that so-called "long-established pattern" because it and his wife's trust were parts of (R. 122–123) "essentially a single transaction", and were not direct gifts from decedent to his wife or children. The subjective motivation underlying these trusts, if that be relevant, simply cannot be determined in disregard of the reciprocity that constituted their most distinguishing feature. If decedent's motive was not tax avoidance, nothing in

[34] The court does not mention in its opinion that Iglehart also disregarded Ross' cautionary advice to him about spacing the two trusts sufficiently far apart as to avoid the appearance of a single plan. (R. 113–115). Nor does it note the 1949 congressional committee reference to the fact that generally reciprocal trusts by husband and wives were created at about the same time. (See p. 23, *supra*.)

this record discloses what did in fact prompt him to arrange his and his wife's virtually simultaneously transfers for each other's benefit, all as part of one transaction.

CONCLUSION

The decision of the Court of Claims should be reversed and the case should be remanded for further proceedings.[25]

Respectfully submitted.

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[25] If the decision below is reversed, the Court of Claims must decide respondents' contention going to the value of the resulting addition to decedent's estate.

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